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RESIDENT RIGHTS AND RESPONSIBILITIES

IN VIRGINIA'S CONTINUING CARE RETIREMENT COMMUNITIES:

Building Trust and Stronger Communities

Written Testimony by
Katherine C. Pearson
Professor of Law
The Pennsylvania State University
The Dickinson School of Law

My deep thanks go to Executive Director Elizabeth Palen, Senator George Barker, the members of the Commission and the citizens of Virginia. I am grateful for the invitation to speak before the Commonwealth's Working Group on Continuing Care Retirement Communities. I believe most of us agree that Continuing Care and Life Care Communities (collectively referred to as CCRCs) are important components of the senior living network, providing older adults with an active, dignified way of life. Everyone here today wants CCRCs to thrive.

I begin with a brief overview on residents' rights and responsibilities with regard to financial transparency and accountability, based on my research during the last six years. My research has included review of state laws and regulations, admission contracts and cases, tours of facilities, communications with operators and managers, and dialogue with representatives of resident groups in Pennsylvania, Florida, Maryland, New Jersey, Massachusetts, Connecticut, New Mexico, Arizona, California, Oregon, and Virginia.

Overview:

Residents in CCRCs have clear financial responsibilities: to pay fees as agreed in their Admission Contracts. Most often, this includes a large entrance fee and monthly fees which will usually be paid for the remainder of the resident's life. There are also important collateral financial terms in the agreements. Residents typically agree (1) to be truthful and forthcoming in their disclosure of all personal liabilities and assets that could affect their ability to pay fees for the remainder of their residence at the CCRCs; and (2) not to waste, encumber or gift their personal assets in a way that would threaten their obligations to pay fees due in the future.

To facilitate the facility's knowledge of the residents' financial standing, CCRCs demand detailed medical and financial disclosures, usually in precise formats that are understandable by the management of the CCRC. The CCRC needs to make informed decisions about whether to admit and retain each resident. CCRCs also routinely require residents to maintain personal health care insurance, including Medicare supplemental policies and long-term care policies, as a condition of continued residence. Private insurance reduces the dollar obligation of the facility for health-related care. If a resident becomes unable to pay all or a portion of future fees, CCRCs can and do demand an accounting of past expenses before granting charitable care. The CCRC has the right to expect truthfulness from residents on these financial matters.

It seems reasonable to expect similar terms of transparency and accountability from the CCRC providers. Research leads me to conclude there are <u>seven</u> finance-related rights that residents increasingly believe are important, whether they live in mission-driven non-profit CCRCs, for-profit CCRCS, or what is increasingly common, the hybrid form of CCRC that qualifies for income tax-exemptions while providing limited charitable care.[1] The first <u>six</u> items are:

[1] Exemptions from federal and state income taxes for CCRCs that operate as fee-paid "nonprofit" entities have historical roots. The Internal Revenue Service has recognized that "homes for the aged" have a "charitable purpose for Federal tax purposes where the requisite elements of relief of distress and community benefit have been found to be present" and this concept has been applied to exempt CCRCs from federal income taxation. See Revenue Ruling 72-124, 1972-1 C.B. 145. See also I.R.S. Priv. Ltr. Rul. 200033050 (May 25, 2000) available at 2000 WL 33119577 (issued in 2000, authorizing Section 501(c)(3) tax-exempt treatment for affiliated CCRCs operating in Maryland and Pennsylvania).

1. The right to organize and advocate for themselves and their fellow residents;
2. The right to be free from retaliation when pursuing their desires or their rights;
3. The right to receive regular, accurate and detailed financial information that affects current and future operations at the CCRC;
4. The right to receive financial information in a form that is understandable to the majority of current and prospective residents;
5. The right to an effective voice in financial decisions that may impact present and future stability of their community; and
6. The means to enforce their rights by reasonable process.

Virginia law already touches on some of these six items. For example, Virginia law provides residents with the right of "self-organization," and ties self-organization to a right to be free from retaliation.[2] Virginia also mandates fairly detailed annual financial disclosure statements to current and prospective residents.[3]

As was well explained by residents during the earlier sessions conducted by this Working Group, many residents want financial information which is understandable not just to those residents who are the retired captains of industry and finance, but to the majority of residents. "Plain language disclosures" are at the heart of any effective consumer protection law. I understand that there is a good dialogue underway among stakeholders about whether Virginia can and will adopt a "plain language" financial disclosure form for all CCRCs operating in Virginia. I commend that approach, although I caution that disclosure laws should never be permitted to function as an excuse for unsound or exploitive financial practices.

Today I am going to focus primarily on one underrepresented item, the right for residents to have an effective voice in financial decision-making. I believe an important step would be for the Commonwealth to join other jurisdictions that require CCRCs to permit residents to serve as voting members on their governing

[2] Va. Code Ann. § 38.2-4910.
[3] Va. Code Ann. §§ 38.2-4903 and 4904.

boards. Voting membership on boards can promote trust among current and future residents, while also encouraging decisions-makers to listen directly to the residents' perspectives on financial stability.

Before I turn to a more detailed review of legal precedents for voting membership, it is important that I acknowledge a <u>seventh</u> item of deep concern to many residents of CCRCs. Residents want to know that the fees they have paid and will continue to pay, including increases, will be affordable to them, and will be only what is reasonably necessary to maintain the stability and success of their community. To give this item a simple label, I will call this the residents' desire for affordable stability.

The desire for affordable stability includes protection for the large entrance fees used by many CCRC models, which may in whole or part be described as refundable. It is rare for residents to be treated as secured creditors. Nonetheless, residents are asked to trust providers to use all fees in a way that will not put their specific community at risk. Residents frequently see escrow or other dedication of unencumbered funds as the solution.

This type of issue is present with virtually all financial products marketed to the public, representing the tension between our free market approaches to enterprise and a desire to reduce the risk of loss for the consumer. The important difference here, however, is the level of indignity attached to risk of loss for the elderly consumers who are the residents of CCRCs.

The owners or operators of CCRCs often believe they are in the sole position to decide on the best use of these fees. Current CCRC providers also rightly emphasize the comparatively small percentage of failed CCRCs and point to the fact that the market has been strong enough to supply new providers to rescue failing operations.

My study of the longer history of CCRCs, however, has shown relatively frequent pockets of instability. Some were dramatic, such as the failure of Pacific Homes, a group of church-affiliated CCRCs in California and Arizona in the late 1970s,[4] and, more recently, the 2009 filing of Chapter 11 proceedings by Erickson

[4] A partial history of the bankruptcy and related suits is set forth at *In re Pacific Homes*, 611 F.2d 1253 (9th Circ. 1980) (ruling that under the facts of the case, the bankruptcy court did not control jurisdiction over the trustee's

Retirement Communities, resulting in corporate reorganization in at least nine states, affecting nonprofit facilities that were home to thousands of CCRC residents. Use of the Bankruptcy Court, of course, is the most extreme response to financial problems, but it can also be a path to reorganization of debt that permits a turnaround of the operation. More importantly, bankruptcy filing statistics should not be viewed as the sole marker of financial concerns.[5]

Further, nonprofit CCRCs are not the only members of the industry making financial decisions that raise affordability concerns for residents. I point to a case in California, where a resident-group filed a class-action suit in 2007 involving a for-profit CCRC developed as a "Classic Residence by Hyatt," now called Vi. The issues included lack of transparency in accounting practices, and whether resident fees were being used properly. The suit resulted in a court-approved settlement, with the CCRC agreeing to limits on future increases on service fees charged to existing residents.[6]

The most recent financial issues can be traced to various reasons. The CCRC industry spokespersons sometimes attempt to minimize the significance of individual problems, arguing they are simply due to unlucky timing of new properties that coincided with the collapse of the credit markets and home sales. However, closer inspection suggests the reasons include mis-forecasting of demand in particular markets by both developers and lenders, irrational exuberance (former Federal Reserve Chairman Alan Greenspan's famous and apt phrase) for growth or expansion, or attempts to enter a market while relying almost exclusively on debt-financing.

Since 2008, lenders have appeared to take a more vigilant approach to how fees are used and this vigilance could benefit residents; however, lenders also insist on priority rights to assets in the event of default, so one cannot rely solely on lending standards to protect residents.

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complaint for breach of fiduciary duty, mismanagement and waste, filed against individuals and governing bodies within the United Methodist Church, thus permitting the case to go forward).

[5] As a recent example, at a nonprofit CCRC in Kansas, family members have filed suits alleging breach of contract for failure to make promised payments of refundable entrance fees. Mark Davis, *Troubled Leawood Retirement Center Can't Give Some Families Refunds,* KANSAS CITY STAR, posted November 27 2012 at www.kanascity.com.

[6] See e.g, the class action filed by residents, Short et al v. CC-La Jolla & Classic Resident Management Limited Partnership, Case No. GIC877707, in Superior Court of California, County of San Diego, in 2007, and the judgment approving the settlement, dated October 3, 2008, that resulted in the provider agreeing to caps on increases to monthly fees for members of the class for ten years.

Affordable stability is the most difficult to legislate as a "resident right," whether in the context of health care, nutrition, housing or social care, and thus it is especially challenging when the context is a full range of continuing care, in CCRCs. Historically, the majority of states that regulate CCRCs have focused more often on mandating disclosure of key information to both regulators and consumers, than on specific regulation of financial holdings or escrow of fees.

Whether to mandate escrow of all or a portion of entrance fees (or reserves of other income) depends in part on one's confidence in the free market system. Actuarial studies can be done.[7] Professional actuaries and certified public accountants with experience in the CCRC industry can provide recommendations to states about whether and how to mandate escrow or reserve accounts as a legislative matter.

I know that CCRC industry groups tend to aggressively resist restrictions on providers' freedom to allocate fees. They lobby against legislative mandates. However, I believe that soundly managed CCRCs *can* explain how and why they use forecasting and actuarial studies to allocate entrance fees and other funds to future health care costs, facility maintenance, entrance fee payment, or growth. Such operators know that the <u>combination</u> of sound financial management practices (including escrow and reserves) <u>and</u> financial transparency are the best way to support their marketing promises about "peace of mind" for CCRC residents.[8] As I said at the outset, states must be wary of arguments that contend that "disclosure" is the best or only solution to consumer risk.

[7] In 2000, California adopted statutory "reserve requirements" for "refundable fee" agreements at CCRCs and in 2004, adopted statutory requirements for "actuarial reporting" on "Type A" CCRC contracts. See Cal. Health & Safety Code §§ 1792.6 through 1792.10, and § 1793. Caution may be necessary in legislative definition of such labels, to avoid facilities treating the labels as narrow loopholes for exploitation, such as marketing a CCRC's entrance fees as "subject to return" rather than "refundable," in order to avoid the statutory reserve requirement.

[8] As an example of the evolving nature of state laws addressing financial transparency and stability for CCRCs, in May of 2012, Maryland amended its CCRC law found at Md. Code, Hum. Serv. §§ 10-401 et seq., in several potentially important ways, including mandating (a) increased financial operating reserves that are unencumbered; (b) disclosure of the extent to which any refundable entrance fees are to be held in trust or escrowed; (c) disclosure of ownership interests; and (d) specific disclosures about the extent to which the provider restricts use of residents' fees for the "construction, operation, maintenance or improvement" of the residents' community, rather than for some other aspect of the provider's corporation mission, for distribution of profits or to benefit an affiliated community. See Maryland Senate Bill 485 and House Bill 556, amending Md. Code Ann., Hum. Serv. §§ 10-401 et seq. (effective October 1, 2012).

In the hope of staying on a road towards progress for this working group study, I turn my focus now to what I think is an important and comparatively easy step to better trust and stronger communities: inclusion of residents as voting members of governing boards.

Background:

I speak from my perspective as a law professor and lawyer. I have been teaching courses on law and aging policy at the Dickinson School of Law for eighteen years, including more than ten years as director the Elder Law and Consumer Protection Clinic at Penn State University. My interest in Continuing Care and Life Care Communities became more than an academic interest through our Clinic's work with resident groups.

Residents at several CCRCs began reaching out to me and our Clinic in 2006, seeking legal information and advice. They were concerned that owners, operators, or managers of their CCRCs were ignoring their questions about certain decisions at their facilities. The concerns raised – at different facilities – overlapped. When I asked whether the residents had consulted their own attorneys or accountants, they explained with obvious sincerity that as individuals they were now strapped for money. As one resident explained, he had paid over a million dollars to his facility in the form of entrance fees and monthly fees. As he was not planning on dying any time soon, he felt he needed to be careful about his remaining retirement assets, as it was clear he had an ongoing responsibility to pay his bills at the facility.

I became intrigued by the questions raised by those first few groups of residents who had traveled from around Pennsylvania to meet with me and my students. These groups represented an extraordinary array of experience, talent and wisdom, including former heads of highly successful businesses. They came from Pittsburgh and Philadelphia and many points in between. As early as 2006, they recognized a softening of the market for CCRCs, with foresight that proved prophetic. The more research my students and I conducted, the more I was impressed by the financial, legal and governance questions raised by the residents. Unfortunately, residents in Pennsylvania often did not have an easy way to get financial questions answered if the CCRC is reluctant to share information.

As an example, at one CCRC in Pennsylvania, the governing board had awarded a contract for renovations to the same company for several years in a row, despite resident complaints about the quality of the contractor's work on individual units. Eventually the residents learned that the head of the contractor's company was also a member of the governing board of their CCRC.

The board's representative told the residents that the organization had complied with its conflict of interest procedures, and the Board Minutes reflected the fact that the individual in question had not participated in the vote to approve his contract. He had "stepped out of the room" before the vote. The residents' group, who included a successful physician and a retired CEO from a major corporation, had an uphill challenge to persuade management that a *better* policy would be to seek both references and competitive bids from other experienced contractors. The management felt defensive in justifying their past decision; the residents felt ill-served by the board.

In Pennsylvania, residents do not have a statutory right to serve on governing boards for CCRCs.[9] Residents do not have a statutory right to meet with anyone other than the individual or individuals designated by the Board.[10] Pennsylvania law does not mandate a dispute process for this type of issue.

Pennsylvania also has not held public hearings about the future of regulation of CCRCs -- or the potential importance of resident concerns.[11]

In the CCRC example I mentioned, both sides dug in their heels. It is easy to anticipate more problems may be ahead for that CCRC. Worried residents find it difficult to be strong ambassadors for their CCRC.

As a result of my opportunities to listen to CCRC residents in Pennsylvania, I soon began to hear from resident groups throughout the United States and I expanded my research focus.

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[9] Pennsylvania's Continuing Care Provider Registration and Disclosure Act, 40 Pa. Stat. Ann. §§ 3201-3225.

[10] 40 Pa. Stat. Ann. § 3215(b)(providing that either the governing board "or a designated representative" shall hold quarterly meetings with the residents for "free discussion of subject which may include income, expenditures and financial matters").

[11] For the author's perspective on post-2008 changes in Pennsylvania oversight of CCRCs, see Katherine Pearson & Joshua Wilkins, *Will Continuing Care Retirement Communities Continue? A Pennsylvania Law Update*, 82 PA. B. A. Q. 69 (April 2011).

Precedent for Residents as Voting Members of Governing Boards:

Six jurisdictions in the United States now mandate that CCRCs permit residents to serve on governing boards. These include New Jersey,[12] Maryland,[13] California,[14] Ohio,[15] Oregon[16] and Washington D.C.[17] New Jersey, Maryland and the District of Columbia also make it mandatory to permit residents to serve as voting members of governing boards.

In seeking greater financial transparency and accountability in governance of CCRCs, New Jersey recognized the importance of effective resident input on decisions that can affect financial stability. New Jersey law takes a two-prong approach and provides:

1. "The board of directors or other governing body of a facility shall consult and discuss with the representatives of the residents any proposed action that might significantly affect the well-being of the residents or the financial stability of the facility, before taking the proposed action;"[18] and
2. "The board of directors or other governing body of a facility shall include at least one resident as a full voting member of the board or body. . . ."[19]

Similarly, under Maryland law, where residents are called "subscribers," if a provider has a governing body, "at least one of the provider's subscribers shall be a full and regular member of the governing body."[20] Further, in Maryland, for

[12] N. J. Stat. Ann. § 52:27D-345 (as amended effective January1, 2008).
[13] Md. Code. Ann. Hum. Servs. § 10-427 (as amended effective October 1, 2007).
[14] Cal. Health & Safety Code § 117.8(j).
[15] Ohio Rev. Code Ann. § 173.13(B).
[16] Or. Rev. Stat. § 101.112(6).
[17] D.C. Stat. § 44.151.10(d).
[18] N.J. Stat. Ann. § 52:27D-345(d).
[19] N.J. Stat. Ann. § 52:27D-345(e).
[20] Md. Code Ann., Hum. Serv. § 10-427(a)(1). Maryland has also recently amended its CCRC laws to require providers to make non-confidential board minutes available to residents within one month of approval. Md. Code Ann., Hum. Serv. § 10-427(c) (as amended effective October 1, 2012). Oregon law emphasizes that while minutes may be redacted for confidential discussions such as pending litigation, employment matters or a resident's personal situation, the provider may not remove information regarding the "annual budget, increases in regular periodic charges, provider indebtedness or expansion in new or existing facilities." Further, in Oregon the provider "shall retain the minutes for no less than three years from the date the minutes were created." Or. Rev. Stat. § 101.112(5).

providers that own or operate "more than three facilities within the State," the governing body "shall include" at least one subscriber for every three facilities.[21]

Maryland law also recognizes the possibility that a CCRC may not have a board as a "governing body." In those instances, the provider is required to "appoint a select committee of its officers or partners to meet at least twice a year with the resident association at each of its facilities to address concerns of the subscribers and to ensure that the opinions of subscribers are relayed to all officers or partners of the provider."[22]

One concern raised by residents is that participation by residents on governing boards should not be token representation nor limited to retired insiders chosen to rubber stamp the owner's goals. This concern points to the importance of the selection process. Under Oregon law, this concern is addressed by the requirement that resident-representatives and any alternate "must be elected by a majority vote of the residents' council of each CCRC or by a majority vote of all residents of a CCRC."[23]

Does it work to have residents as voting members of governing boards? In April 2011, I met with more than 150 CCRC residents and state officials at a state-wide residents' organization in New Jersey. I heard from residents who spoke positively about their experiences on governing boards. Voting membership on boards appears to contribute to a sense of shared responsibility by all members of the board. One community voluntarily increased the number of residents who were voting members on their boards; the owner's appreciation for resident input increased over time.

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[21] Md. Code Ann., Hum. Serv. § 10-427(a)(2).

[22] Md. Code Ann., Hum. Serv. § 10-427(b)(1)(regarding providers without a governing body). This alternative in Maryland's law, recognizing the possibility the CCRC may not be organized as a separate corporation with a traditional board of directors or trustees, reduces the likelihood of a problem that occurred in one New Jersey CCRC, where the direct provider was a church, the church was not separately incorporated, and the church objected on First Amendment grounds ("freedom of association") to a statutory role in church governance for someone who was not a member of the church. *Wiley Mission v. New Jersey*, 2011 WL 3841437 (D.N.J. 2011) (unreported trial court opinion, granting declaratory judgment to church, citing state constitutional grounds).

[23] Or. Rev. Stat. § 101.112(7). In the District of Columbia, the law requires the resident's board member to be elected by "vote of the residents of the facility." D.C. Stat. § 44-151.10(d). In New Jersey, the law provides that resident members are "nominated" by the residents and "selected" by the board of directors or other governing body. N.J. Stat. Ann. § 52:27D-345(e).

Having multiple resident-members on a board also permits staggered terms, which facilitates professionalism and continuity of knowledge and participation. However, the presence of residents on a board does not eliminate the importance of regular board communication with the larger community of residents. The state resident organization in New Jersey -- with the catchy acronym of ORANJ -- conducted a transparency study in late 2010. By then, twenty of twenty-two CCRCs had elected residents to sit on their boards. Review of the study suggested that residents felt financial transparency – and therefore trust -- was facilitated by active involvement of residents on the governing board, but also by frequent meetings between board members and the larger population of residents.[24]

Individuals experienced in the management of CCRCs have also expressed understanding of the importance of resident participation in governance. In September 2012, Rick Exline, Executive Vice President of Life Care Services, noted that with the economic pressures on CCRCs, residents are more interested in financial decisions. He said, "Some states require residents to be on the board. You have to be careful about a conflict of interest, but I think it can be done successfully."[25]

In reviewing submissions made to previous meetings of this Working Group, I noticed a series of communications between residents and a non-profit CCRC, in which the provider denied the residents' request for a seat on the governing board, citing potential conflicts of interest as a reason. I believe it is rare for disqualifying conflicts of interest to occur. Most of the time, the interests of any individual resident and the CCRC align exactly, as residents are committed to the long-term success of the entity. The role of the board as a whole is to use its best informed judgment to accomplish this goal.

As addressed by the Virginia Attorney General in an opinion letter written in 2000, each director of a nonprofit organization must discharge his or her duty by using "good faith judgment of best interests of the corporation."[26] On the

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[24] ORANJ Residents' Transparency Study, November 20, 2010, available at http://oranjccrc.org.

[25] Alyssa Gerace, "On the Record: Rick Exline, Executive Vice President of Life Care Services," Senior Housing News. September 30, 2012 (available at http://seniorhousingnews.com).

[26] Attorney General Opinion, dated September 25, 2000, addressed to members of the Virginia legislature, available at 2000 WL 1545003, citing Virginia's laws on nonprofit corporations at Va. Code Ann. § 13.1-870 (General standards of conduct for directors).

question of conflict of interest for residents as voting members, the Attorney General concludes, "The mere fact that an individual is a resident of the CCRC is certainly no automatic compromise of his good faith judgment nor is his residency at the facility tantamount to a personal interest in a transaction." Indeed, as suggested by the Pennsylvania experience recounted above, residents may understand the concept of conflict of interest as well as or even better than general members of boards.

Conclusion:

Granting residents the right to fill one or more seats as voting members of governing boards of CCRCs is one way that the Commonwealth of Virginia can facilitate greater transparency and accountability in the governance of CCRCs. In addition, tapping into the energy, commitment and wisdom of community members is a cost-effective means of enhancing the Commonwealth's oversight for CCRCs. This consumer protection measure is also "revenue neutral" for state governments.

Admittedly, providing for resident-members is not a guarantee of solvency for CCRCs. There will also be a learning curve for everyone as resident-members take their seats for the first time. Resident-member must accommodate their resident perspective to their fiduciary obligations to the enterprise as a whole. And for this reason, it is still important to have state laws that require facilities to share accurate, timely and understandable information about financial matters with all interested residents.

In conclusion, in 2010, during the U.S. Senate hearings on financial risk in CCRCs that followed the Erickson Community bankruptcy proceedings, it became apparent that the federal government was concerned about consumer risk but was also overwhelmed by other, larger needs for consistent, national regulation. The closing words of the GAO study that accompanied the CCRC hearings serve as a necessary reminder that states, such as Virginia, are still the first-line responders. The report demonstrated the "importance of states being vigilant in their efforts to help ensure that CCRC residents' long-term interests are adequately protected."[27] I commend Virginia's actions in this effort.

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[27] U.S. Government Accountability Office, *Continuing Care Retirement Communities Can Provide Benefits, but Not Without Some Risk*, Report (GAO-10-611) to the Chairman, Special Committee on Aging, United States Senate,

at page 34 (June 2010).